One Hundred and Twenty-Second Sovereign Debt News Update: The IMF and World Bank Approve $4.9 Billion Debt Relief to Ignite Debt Restructuring Efforts for Ethiopia

By:

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The IMF and World Bank Approve $4.9 Billion Debt Relief to Ignite Debt Restructuring Efforts for Ethiopia Ethiopia has been facing a complex economic and political crisis, characterized by a significant debt burden, a heavy reliance on imports, a significant trade imbalance, and ongoing civil conflict. According to the Ethiopia's Ministry of Finance, total external debt stood at $28.38 billion in March 2024. However, due to a civil war and the flaws of the common framework, a protracted debt crisis for Ethiopia has carried negative repercussions as the economy has been on the verge of collapse. As reported in the Seventy First Sovereign Debt News Update in March 2023, Ethiopia turned directly to China and France in quest for debt relief (and to no avail). The "final straw" was when Ethiopia became the third African country to default on its sovereign bond in December 2023. As such, the authorities in East Africa's biggest economy have had to resume talks to reduce its debt-repayment burden by lengthening maturities after agreeing a reform program with the International Monetary Fund (IMF). In order to understand the relevance of the $4.9 billion in debt relief, it is imperative to give a political economy analysis of Ethiopia's debt situation by contextualising Ethiopia within its economic reforms and political instability, as well as spotlighting the role of international financial institutions such as the IMF in the adoption of such reforms.

Ethiopia's Home-Grown Economic Reform Plan (HGER 2.0)

On December 20, 2019, the IMF Board approved a three-year arrangement under the Extended Credit Facility (ECF) and the Extended Fund Facility (EFF) for Ethiopia, worth $2.9 billion, to help the country implement the 2019 Homegrown Economic Reform Plan, maintain macroeconomic stability, and improve living standards. However, the programme was suspended due to conflict in the northern region of Tigray, and negotiations resumed after a peace deal signed in November 2022.

In implementing Ethiopia's Macro Economic Reform Program, the National Bank of Ethiopia (NBE) adopted a market-determined foreign exchange rate to secure a new IMF lending programme and to make progress on a long-delayed debt restructuring. The IMF's reform package, based on the country's Home-Grown Economic Reform Plan (HGER 2.0) (extended in 2022) aims to restore macroeconomic stability, boost private sector activity and ensure sustainable, broad-based and inclusive growth. Expounding on the economic reforms during a televised event, Prime Minister Abiy Ahmed said the new exercise would include savings of $200 million from the restructuring of its $1 billion Eurobond. According to Abiy, the switch to a market-determined foreign exchange *rate aims to close the gap between the official and black-market rates and does not amount to a devaluation of the currency*.

Over the following four years, the central bank predicts that these adjustments may enhance a number of economic indicators, including: economic growth, a decline in inflation, and increases in exports and foreign direct investment. However, the NBE noted that these projections are based on the successful implementation of the policy package.

National Bank of Ethiopia (NBE)'s Foreign Market Reform

On 29 July 2024, and in response to government's announcement regarding Ethiopia's macro-economic reform program, the National Bank of Ethiopia (NBE) announced a major overhaul of the country's foreign exchange system, marking a significant shift towards a market-based economy. The reforms, effective from the date of announcement, aim to address long-standing economic distortions and attract foreign investment. The new policy introduces a competitive, market-based exchange rate and eliminates various restrictions on foreign currency transactions. As such, foreign exchange will now be retained by exporters and commercial banks to substantially increase the supply of foreign exchange to the private sector, effectively eliminating the previous surrender requirements to the NBE.

Apart from the elimination of surrender requirements to the NBE, key elements of the reform include *the removal of import restrictions on certain product categories, and improved retention rules for exporters*. The NBE also announced *the introduction of non-bank foreign exchange bureaus and the simplification of rules governing foreign currency accounts*. The government intends to impose temporary subsidies on imports of necessities including fuel, fertilizer, medication, and edible oil in order to lessen any potential negative effects. In order to mitigate the effects of inflation, the NBE also suggested taking other steps, such as providing financial assistance to civil servants and expanding the Productive Safety Net Program.

The reform is supported by a reported $10.7 billion financial package from Ethiopia's external partners, including the IMF and World Bank. The NBE described this as a significant commitment of support for Ethiopia's economic reforms. However, following the announcement by the NBE, the Commercial Bank of Ethiopia (which is the country's biggest lender) had reported a buying rate of 74 and a selling rate of 76 birr per 1 USD, showing that the birr had lost 30% against the dollar within a day.

The IMF and World Bank's Combined $4.9 Billion Worth of Debt Relief

The government of Ethiopia clinched an IMF deal worth $3.4 billion and $1.5 billion credit from the World Bank for debt restructuring efforts (giving a total of $4.9 billion). Setting the key parameters for creditors to negotiate restructuring deals with the government, the IMF said Ethiopia needed about $3.5 billion in relief from debt restructuring through 2027-28. The announcement of the four-year, $3.4-billion programme came hours after Ethiopia had undertaken one of the IMF's key recommendations (easing forex curbs) and floated its currency, the birr. Additionally, the IMF said it would immediately release about $1bn for Ethiopia to help its “balance of payments needs and provide support to the budget”.

In a report outlining its $3.4 billion economic program, the IMF said the nation faces a financing gap of more than $20 billion over the period. That reduces to $10.7 billion after actions including proceeds from privatization processes and an existing debt. In addition to the World Bank-approved $1 billion credit, the World Bank's International Development Association (IDA) will also grant a $500 million concessional credit to Ethiopia. News of the IMF deal saw a record high for the $1 billion government bond at the heart of the restructuring plan. This was the highest level since October 2021, as it was trading for about 78 cents on the dollar, or slightly over a 20% discount to its initial face value, following a more than 2 cent increase.

According to State Finance Minister Eyob Tekalign, Ethiopia will enjoy $4.9 billion in relief from debt repayments when it completes its current restructuring exercise. Minister Tekalign added that the new $3.4 billion financing deal with the IMF paves the way for completion of its long-delayed debt restructuring, which should be finalised before the next IMF programme review (approximately between the next three to six month).

Analysis 1: Why the Sudden About-Turn Towards Market Reforms?

It is crucial to emphasize that Ethiopia has previously rejected IMF guidance in favour of a more interventionist course of action. The Ethiopian government previously managed the exchange rate, restricted imports and directed the flow of credit, believing that market-oriented reforms were a “dead end”. However, in order to provide Ethiopia with a bailout, the IMF required a good faith measure that solidified Ethiopia's intent to implement a more flexible foreign exchange regime. This would set the scene for a series of stepwise devaluations on the path to foreign exchange liberalisation and monetary policy reform flexible, market-determined exchange rates.

According to Connor Vasey, a consultant at J.S. Held, Ethiopia *probably preferred a more gradual devaluation but had a weak negotiating position*. However, after defaulting on a bond payment last year, and with other creditors insisting upon an IMF deal, the Ethiopian government has been left with little choice but to turn toward market reforms. The reforms are expected to help address the long-standing macroeconomic challenges, ensuring price stability, and fostering economic growth in the East African country, and Fitch Ratings holds that Ethiopia’s reforms will likely accelerate debt restructuring. Be that as it may, the reforms pose a great blow on the economy and the citizens in the short term.

Analysis 2: Impact of Ethiopia's Market-Based Exchange Rate on Citizens

Ethiopia’s new economic programme, being supported by the IMF, is intended to stimulate private sector led growth as the government and its creditors say the liberalisation will help the private sector make a bigger contribution to the economy and boost long-term growth. Concurring with this position, the American Embassy in Addis Ababa commented on the shift, stating, “*Implementing a market-based foreign exchange system is a tough but essential move for addressing Ethiopia’s macroeconomic issues*.” However, some economic analysts and commentators have voiced concern that the market-based foreign exchange rate could drive up inflation and the cost of living, especially for the poorest.

While lifting foreign exchange trading restrictions helped Ethiopia clinch the IMF deal and funding from other creditors including the World Bank, concern about the policy's inflationary impact on low-income households has led at least two local governments to crack down on shops raising prices, with more than 2,000 stores for "unjustified price hikes and hoarding" after the new exchange rate policy was put in place. Traders in the capital said the price of cooking oil had gone up by around 25% following the central bank's move. According to Kassahun Gofe, Ethiopia's minister for Trade and Regional Integration, the country imported 14 million litres of cooking oil to ensure sufficient supplies of the basic commodity.

It is crucial to emphasize that the National Bank of Ethiopia made the choice to switch to a market-based currency rate amid a humanitarian crisis and an unstable economy. As has been witnessed with regards to cooking oil, the devaluation of the currency is likely to lead to increased prices for imported goods, particularly essential items. Citizens' purchasing power will be diminished by this, particularly for those with lower incomes. Shortages of necessities could arise if foreign exchange reserves are not sufficient to pay for imports, further exacerbating the cost-of-living crisis. There is a likelihood that the state of the economy as a whole will worsen, which might result in lower incomes, increased unemployment, and higher rates of poverty. Ethiopia runs the risk of relapsing into war as the economic downturn, combined with the ongoing conflict, could worsen the humanitarian situation.

Given the confluence of forces influencing Ethiopia, the likelihood of these negative effects is unquestionably high. The risk of negative outcomes for citizens is increased by the nation's high reliance on imports, the prolonged conflict, and the government's preference for military spending over social development. The shift to a market-based exchange rate in Ethiopia (while potentially offering long-term benefits such as increased exports, economic stability and growth) is likely to have severe negative consequences for the population. Further, the shift, which is at the behest of the IMF, can be easily interpreted as the reincarnation of the structural adjustment programs (SAPs) implemented in the1980s. If lessons from Zimbabwe, Somalia, Ghana and Nigeria are anything to go by, SAPs, as promoted by the World Bank and the IMF, deepened the socio-economic devastation, from which these ailing countries have not been able to recover (decades later). Thus, while the Ethiopian government continues to put in considerable efforts to get debt relief and have the country back on a sustainable debt trajectory, a private sector-led economy is most likely to prioritise profits over people.

Conclusion

It is imperative to highlight that the 3.4 billion extended credit facility for Ethiopia comes after five years of negotiations. However, the cost of such “debt relief” for the average citizen does only worsens their plight. Addressing

Ethiopia’s underlying economic and political challenges is crucial to mitigate these impacts and create a sustainable path to recovery. More debt is certainly not the solution to Ethiopia’s debt crisis. Ethiopia urgently needs a people-centred solution, and the AfSDJN notes that Ethiopia's experience continues to demonstrate the need for a new comprehensive, fair, and effective sovereign debt restructuring system based in the United Nations, and that is binding on all creditors, including commercial creditors.

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